

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6716

Petition of Vermont Electric Cooperative, Inc.)
for approval to Secure Repayment Obligations)
in Connection with \$1,800,000 of Proposed)
Letters of Credit)
)

Order entered: 7/1/2002

I. INTRODUCTION

This case involves a petition filed by Vermont Electric Cooperative, Inc. ("VEC") on June 25, 2002, requesting approval under 30 V.S.A. § 108 to pledge its property to secure the issuance of Letters of Credit necessary: (1) to comply with amendments to the ISO New England Inc. ("ISO-NE") Financial Assurance Policy implemented May 20, 2002; and (2) to satisfy the requirements imposed by potential power suppliers with whom VEC is negotiating to secure a new firm power contract to commence January 1, 2003. The deadline for compliance with the ISO-NE Financial Assurance Policy is July 1, 2002. In addition to the petition, Petitioner has submitted the Prefiled Testimony of Pamela J. Jarvis ("Jarvis pf.") and Craig Kieny ("Kieny pf."), Proposed Findings, and a Proposed Order. VEC has requested expedited consideration of this petition and has waived its rights under 3 V.S.A. § 811 to review any Proposal for Decision, and to present comments and argument thereon.

In addition, on June 27, 2002, the Vermont Department of Public Service ("DPS") informed the Board, pursuant to 30 V.S.A. § 202(f), that the repayment obligation in connection with the \$1,800,000 of proposed Letters of Credit is consistent with the Vermont 20-Year Electric Plan.¹

1. This determination does not imply approval of the capital structure resulting from any financing, or use of funds raised by this financing for purposes other than those specifically described in the documents listed above and subject to the conditions contained herein.

I have reviewed the petition, the supporting testimony and exhibits, and correspondence from the DPS, as described above. I conclude that approval of VEC's petition to authorize the repayment obligation in connection with the \$1,800,000 of proposed Letters of Credit is appropriate and may occur without a hearing.

Based on the petition and the supporting testimony and exhibits presented in this Docket as described above, I hereby report the following findings and conclusions to the Board in accordance with the provisions of 30 V.S.A. § 8.

II. FINDINGS

1. Vermont Electric Cooperative, Inc. is a duly organized electric cooperative, existing under the laws of the State of Vermont, with its principal place of business at 182 School Street, Johnson, Vermont. Petition at 1.

2. VEC has obtained a commitment for a \$1,800,000 "Guidance Line of Credit" with KeyBank National Association for the issuance of standby Letters of Credit. Presently, VEC contemplates using the line of credit for two purposes. First, VEC intends to satisfy recent NEPOOL requirements with the issuance of a Letter of Credit in the amount of \$175,000. Second, VEC intends to secure its obligations under power supply arrangements that it is currently negotiating with a Letter of Credit not to exceed \$925,000. If drawn upon, the Letters of Credit will be repayable in less than a year and, in the aggregate, will amount to less than 20% of VEC's total assets. Such financings are normally exempted from Public Service Board approval under 30 V.S.A. § 108(b). However, VEC proposes to secure its obligations under the Guidance Line of Credit with a pledge of its accounts receivable and an assignment of the power supply arrangements to be secured with the Letter of Credit. Jarvis pf. at 1, 2, 5; Kieny pf. at 4.

3. The Letters of Credit will not be issued unless VEC needs them for the transactions outlined herein. They will not be drawn on as long as VEC has not defaulted in any of its obligations to ISO-NE, in the case of its monthly net charges due ISO-NE; or to the power suppliers, in the case of the Edison Electric Institute ("EEI") Master Power Contracts. Rather, they are available only in the event of a default by VEC. Jarvis pf. at 3, 4.

4. VEC will enter into a master reimbursement and security agreement with KeyBank National Association, that will require VEC to repay, with interest at the prime rate plus 2% per

annum, any drawings under any Letter of Credit issued by KeyBank. VEC's repayment obligation will be secured by a pledge of its accounts receivable. KeyBank also requires an assignment of the power supply agreements for which Letters of Credit are issued. Jarvis pf. at 4.

5. It is expected that all collateral provisions will be put into effect up-front, even before any Letters of Credit are issued. That is, at the initial closing, VEC will execute the reimbursement and security agreement with KeyBank providing for a pledge and security interest in all of VEC's accounts receivable. VEC will also assign any future power supply contracts that VEC may enter into and for which KeyBank issues a Letter of Credit. Having these security provisions in place now will expedite the issuance of any future Letters of Credit when it is needed. Particularly, the EEI Master Power Contracts require that performance assurances be provided within three business days of the date triggering the need for such performance assurances. Jarvis pf. at 4, 5.

6. In the event there is a drawing under a Letter of Credit, VEC will be required to repay KeyBank the principal of such drawing within 364 days. The maximum amount of all Letters of Credit issued on VEC's behalf, together with all other indebtedness payable within one year, does not exceed 20% of VEC's total assets. However, because VEC will be required to pledge assets to KeyBank, VEC seeks PSB approval of such pledge and the granting of a security interest in VEC's accounts receivable and power purchase contracts. Jarvis pf. at 5.

7. KeyBank was selected because VEC has an established banking relationship with KeyBank. VEC had previously solicited a proposal from KeyBank to finance some long-term debt, and therefore, KeyBank is familiar with VEC's business operations and financial condition. More importantly, the EEI Master Power Contracts require that the bank issuing any Letter of Credit as financial assurance be rated by either Standard & Poor's or Moody's as "A-" or "A3", respectively. KeyBank fits this requirement as it has an "A1" rating from Moody's while many other local banks are either not rated or have ratings that are just at the threshold level. Jarvis pf. at 5.

8. VEC is a member of Vermont Electric Power Company, Inc. ("VELCO") and a Participant in the New England Power Pool ("NEPOOL") through its membership in VELCO. On May 20, 2002, ISO-New England ("ISO-NE") implemented amendments to its Financial

Assurance Policy applicable to NEPOOL Participants. The ISO-NE Financial Assurance Policy requires that all ISO-NE Participants who are considered Non-Municipal must meet certain credit threshold requirements in order to remain a Participant in ISO-NE. The Policy is applicable to VEC by virtue of its membership in VELCO. Petition at 1-2; Kieny pf. at 1.

9. The recent amendments require Participants to provide Financial Assurances through the establishment of a "Credit Limit" and/or by providing "Additional Financial Assurances," the aggregate sum of which must be sufficient to satisfy the "Credit Test Amount" referred to in Section II.B.4. of the Policy. If a Participant's aggregate outstanding obligations to ISO-NE and NEPOOL rise to a level equal to the Credit Test Amount, the Participant shall, among other things, be suspended from making purchases in NEPOOL. The Policy also provides for notice to the Participant when its outstanding aggregate obligations reach 80% of its Credit Test Amount and again when they reach the 90% level. Kieny pf. at 2.

10. The policy has less stringent requirements for municipal utilities. By virtue of its public ownership, VEC proposed that it be treated as a municipal utility. However, the proposal was rejected by ISO-NE. Kieny pf. at 2.

11. VEC was advised by ISO-NE that the applicable provisions for the establishment of a "Credit Limit" contained in Section II.B. of the policy required providing quarterly financial statements prepared by an independent Certified Public Account. VEC's quarterly financial statements are prepared internally. Kieny pf. at 2, 3.

12. VEC's Credit Test Amount will be satisfied by providing "Additional Financial Assurance." As outlined in Section IV of the policy, the acceptable forms of Additional Financial Assurances include cash deposits, letters of credit, payment bonds and, under certain circumstances, corporate guarantees. VEC has determined to meet its requirements through a Letter of Credit. Kieny pf. at 3.

13. The minimum level of additional financial assurance required by Section II.D. of the policy is an amount not less than three and one-half (3.5) times the average of VEC's net monthly charges averaged over the most recent three-month period. VEC's average net monthly charges due ISO-NE are approximately \$30,000, but those charges can fluctuate greatly from month to

month due to congestion charges²³. In order to provide a buffer against such fluctuations, VEC believes it to be prudent to post a Letter of Credit of approximately five to six times its average monthly bill or \$175,000. Kieny pf. at 3.

14. VEC considered joining the Vermont Public Power Supply Authority but the fees for joining that organization are higher than the cost of the Letter of Credit. Kieny pf. at 4.

15. The consequences of a Vermont utility failing to provide adequate financial assurances is significant for the State as a whole. Section I of the Policy provides that, if a group of members is treated as a single participant – as is the case for VELCO – the failure of a single member of that group could jeopardize the NEPOOL standing of the entire group. Kieny pf. at 4.

16. VEC is currently negotiating with three potential suppliers of electricity to replace VEC's existing all-requirements contract that expires on December 31, 2002. Suppliers now require purchasers to post collateral for contracts when forward market prices of the products they are purchasing are lower than the contract prices. Almost all power suppliers have been using the Edison Electric Institute Master Power purchase and Sales Agreement (the "EEI Master Power Contract"). The EEI Master Power Contract requires that each party, under certain circumstances, provide collateral security to the other party. VEC does not expect that the required Letter of Credit will exceed \$925,000. Kieny pf. at 4.

17. Collateral may be in the form of cash, Letter of credit or some other agreed upon "asset." Without a Letter of Credit, VEC may be required to post cash as collateral. Kieny pf. at 5.

18. The collateral posted is based on the volume of the transaction through the duration of the contract and the difference between the per-unit contract of the forward market and the per-unit cost of the contract. Suppliers often grant purchasers a "Collateral Threshold," which is typically a total dollar amount that the contract must be above-market before any collateral is posted. When there is a Collateral Threshold amount, the amount of collateral to be posted is reduced by the Collateral Threshold amount. Kieny pf. at 5.

2. It should be noted that for the purposes of determining the Credit Test Amount, Additional Financial Assurances are divided by three and one-half (3.5).

19. The three potential suppliers with whom VEC is negotiating are not offering VEC any Collateral Threshold until rates are approved that allow VEC to meet its bond covenants. VEC is currently preparing a rate filing for such purposes. VEC needs the Letter of Credit to act as collateral at least until a rate increase is approved. Having the Letter of Credit approved now will allow VEC to enter into a contract for 2003 when it is most appropriate to do so. Kieny pf. at 5.

20. The amount of the VEC Letter of Credit is set at the discretion of the supplier, based on the suppliers' assessment of the risk arising from the sale. In Mr. Kieny's judgment, the maximum Letter of Credit required would be \$925,000. This number was arrived at based on the following assumptions:

- (1) assuming VEC will purchase up to 162,450 MWH in 2003;
- (2) allowance for energy prices to drop to approximately where they were in January 2002, the lowest point of the year; and
- (3) a purchase price approximately equal to the average cost of offers we received in response to VEC's initial Request for Proposals. Responses were received on April 12, 2002.

Kieny pf. at 7.

III. CONCLUSION

On the basis of the evidence of record, I recommend that the Board grant VEC's Petition for approval to secure repayment obligations in connection with the \$1,800,000 of proposed Letters of Credit. The use of the Letters of Credit will improve the financial position of the Cooperative, its ability to provide service to its customers and employees, and is consistent with the general good of the State of Vermont.

I also recommend that this matter be decided without hearing, and that the Board adopt the conditions contained in the DPS 202(f) Determination.

All parties to this proceeding have waived the opportunity to comment on this Proposal for Decision in accordance with 3 V.S.A. § 811.

DATED at Montpelier, Vermont, this 1st day of July, 2002.

s/Ennis John Gidney

Ennis John Gidney

Hearing Officer

IV. ORDER

It Is Hereby Ordered, Adjudged and Decreed by the Public Service Board of the State of Vermont that:

1. The Findings and Conclusion of the Hearing Officer are adopted.
2. The pledge of Vermont Electric Cooperative, Inc.'s ("VEC") accounts receivable and the assignment of VEC's future power supply contract to secure the issuance of the Letters of Credit described herein and pursuant to the Guidance Line of Credit to be issued by KeyBank National Association will be consistent with the general good of the State of Vermont.
3. This Order does not constitute approval of any particular capital or operating expenditure nor the underlying capital structure that Vermont Electric Cooperative, Inc. may implement with the proceeds from the issuance of Letters of Credit by KeyBank National Association. Nothing in this approval shall preclude the Vermont Public Service Department or any other party, or the Vermont Public Service Board, from reviewing or challenging those expenditures and/or VEC's resulting capital structure in any future proceeding.

Dated at Montpelier, Vermont, this 1st day of July, 2002.

_____ s/Michael H. Dworkin _____)	
)	PUBLIC SERVICE
)	
_____ s/David C. Coen _____)	BOARD
)	
)	OF VERMONT
_____ s/John D. Burke _____)	

OFFICE OF THE CLERK

FILED: July 1, 2002

ATTEST: s/Susan M. Hudson

Clerk of the Board

Notice to Readers: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.